B2000 - 1

CHEMICAL

Financial Digest

Volume XXIX, Number 13 Monday, June 29, 1992

Analysis of Business Trends Plus Selected Financial Indicators

Whiff Of Inflation?

Although today's business recovery is admittedly lackluster, a growing minority of financial market participants is detecting a whiff of inflation in the economic winds. For notwithstanding the virtual evaporation of producer price inflation and the muted pace of consumer price increases (Financial Digest—May 18, 1992), policymakers and investors are turning a wary eye toward the rise in industrial commodity prices, the escalation of oil prices, the crop damaging effects of drought in the Midwest and the torrid growth of bank reserves. While these developments have yet to reach a critical price-boosting mass, there are no guarantees that they won't.

For the near term, however, the odds still favor the view that today's inflation-friendly environment will persist. Not only has a slack labor market blunted wage pressures and a lethargic economy loosened industry operating rates but consumers and businesses alike are in a mindset to throttle the inflation threat. With consumers increasingly patronizing such retailing discounters as Wal-Mart and Home Depot the ripple effects are washing up on a growing number of manufacturers who are insisting on supplier price concessions—or telling them to take their business elsewhere.

Economics Department 17/270

Judging by the most recent price statistics, the likelihood of accelerating inflation seems slim. According to the Labor Department, consumer prices advanced by a paltry 0.1 percent in May, bringing the rise over the past year to 3.1 percent, or less than half the rate of rise being posted as recently as late 1990. Producer price trends last month were seemingly more menacing. These prices rose 0.4 percent in May, the sharpest monthly gain since October 1990. However, with most of the increase attributable to a spurt in tobacco prices and, to a smaller extent, aircraft prices, any inflation qualms were short-lived. Even with the aberrant May gain factored in, producer prices for finished goods have barely budged over the past year.

Some Negatives

The differences in inflation opinions stem not from these numbers, which would hardly stir even the most bearish inflation watcher, but from what comes next. Some concern has centered around the rise in industrial commodity prices, one of the most sensitive barometers of price pressures. After reaching their most recent low in early February, these prices have since risen by better than eight percent, pushed higher by double-digit price increases for such items as tin, zinc and cotton. Although the ascent of raw industrial commodity prices is far more subdued during this recovery than in the past, the true test may be yet to come. Only now is a sustained business upswing in progress and commodity prices are rising true to form. What is more, with inventories decidedly leaner throughout the production chain this time around than during the initial stages of past recoveries, the breathing room between any spending jump and a pickup in the demand for, and prices of, crude and intermediate goods may actually be thinner than in the past.

Nor is the behavior of oil prices and, potentially, food prices helping matters. Although it had almost bordered on conventional wisdom outside the energy industry that oil prices would trend lower this year, they have headed in the opposite direction, rising by 20 percent since December—and the demands associated with the summer driving season are only now taking shape. So, too, drought in the nation's grain belt has darkened the food price outlook. Illinois in May experienced its second driest month in weather-record history causing extreme damage to crops across the state; the governors of Wisconsin, Iowa and Nebraska are contemplating disaster declarations and dry conditions extend west into the Dakotas and east into Ohio. Of course weather patterns could change, but they aren't expected to anytime soon.

Rising food, energy and industrial commodity prices could, however, be temporary blips. What really provides inflation worriers with ammunition is the potential impact of the torrid growth of bank reserves which has accompanied Federal Reserve efforts to jump-start the economy. The argument that M-2 money supply growth is too anemic to support a sustained recovery, not to mention an acceleration of inflation, simply diverts attention from the real issue. With total bank reserves expanding at an annual rate in excess of 15 percent this year and the transactions-related M-1 money supply now growing at a nearly 14 percent annualized clip,

Copyright 1992 Chemical Banking Corporation 270 Park Avenue, New York, NY 10017

a volatile mix is brewing which could ultimately produce an explosion of bank credit and liquidity—the all-too-common ingredients for an inflation-wracked recovery.

Split Personality

While the negatives in the inflation outlook should not be ignored, neither should the array of powerful inflation-dampening influences. These range from such factors as spare industrial capacity and rising labor productivity to an acute case of cost consciousness on the part of consumers and businesses—changing the face of domestic retailing and putting starch in the backbones of industrial purchasing managers. Take, for example, industry operating rates. Reflecting the slow recovery, they generally hover below the 80 percent mark, ensuring plenty of room for increased output before triggering production bottlenecks and rising prices. At the same time, however, the business upturn has been sufficiently pronounced to boost productivity. For all nonfarm business, labor productivity jumped 2.6 percent in the first quarter compared with quarter-earlier levels; since this gain outran a 2.2 percent quarterly hike in compensation costs, labor costs per unit of output—the key determinant of cost pressures—fell

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/10/92)	147,971	- 924	- 47,469
New York City (6/17/92)	25,867	- 946	- 5,624
Commercial Paper (6/17/92)	547,483	+ 6,101	+ 712

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/10/92)	281,233	- 2,815	- 28,229
New York City (6/17/92)	48,938	+ 364	- 7,046

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (6/10/92)	1,003,638	- 101	- 33,768
New York City (6/17/92)	161,068	+ 1,880	- 11,988

Financial Markets

	Friday 6/26/92	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	3.70%	–0–	- 1.98
180-Day Bills†	3.82	- .04	- 2.10
Longest Bills†	4.10	- .03	- 2.20
Recent Issues:			
5s 6/30/94 (When Issued)	4.88	- .10	
6⅛s 6/30/97 (When Issued)	6.33	- .09	
7⅛s 5/15/02	7.14	- .09	
8s 11/15/21	7.78	- .05	
Municipals:			
Bond Buyer—20 Bond Index* (6/25/92)	6.42%	- .04	- .71
Blue List Total ($ Million)	$1,269	+ $ 4	- $ 125
30-Day Visible Supply ($ Million)	$3,460	- $341	+$2,055
Total	$4,729	- $337	+$1,930
Corporates:			
Moody's Aa Composite (6/25/92)	8.53%	–0–	- .77
30-Day Visible Supply ($ Million)	$ 550	- $625	+$ 175
Stocks:			
Dow-Jones Averages:			
Industrials	3,282.41	- 2.94	+375.66
Transportation	1,277.65	- 25.79	+124.43
Utilities	209.69	- 3.82	+ 12.88
65 Stocks	1,146.88	- 10.73	+115.96
N.Y.S.E. Composite Index	221.68	- .28	+ 18.51
N.Y.S.E. Avg. Daily Vol. for Week (000's)	215,559	- 18,265	+55,569

*34% Taxable equivalent 9.73%.

† Bond equivalent.

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Friday 6/26/92	Week Ago
Overnight	3.88%	3.75%
1 month	3.88	3.75
3 month	3.94	3.81
6 month	4.06	3.94
1 year	4.38	4.38

FOREIGN EXCHANGE SPOT RATES

New York Opening (6/26/92)	Currency Per U.S. $	Week Ago
Belgium	31.26	32.37
Canada	1.1920	1.1979
France	5.1906	5.3016
Germany	1.5435	1.5750
Italy	1166.03	1189.21
Japan	125.80	127.09
Mexico	3117.51	3119.01
Netherlands	1.7390	1.7720
South Korea	790.00	805.75
Switzerland	1.3855	1.4220
Taiwan	24.43	24.42
U.K.*	1.8894	1.8583

*U.S. $ per U.K. pound

CHEM TRADE-WEIGHTED DOLLAR (6/26/92) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+1.1%	-17.8%

slightly in the first quarter, the first time this has happened since the mid-1980s.

The drop in unit labor costs couldn't have come at a more propitious time for corporate America. Perhaps the biggest change in the inflation environment is in the defiant attitude of consumers toward higher prices. With job security increasingly problematic and income growth slowing, cost-conscious consumers are embracing retailing discounters with unabashed enthusiasm. Discount stores now account for more than 40 percent of general merchandise retail sales and nearly one-third of apparel sales.

Faced with a non-stop loss of market share in recent years, higher-priced retailers are scrambling to bolt down costs and hold the line on prices. And this message has not gone unnoticed by manufacturers, with such corporate giants as General Motors insisting that suppliers trim prices or look for business elsewhere. In this environment, inflation is being forced to transfigure itself, exhibiting an unusual split personality. Capped at the finished goods level and outwardly placid, the consumer reaps the benefits; alive and kicking at the raw materials level, inflation inwardly boils, and the middleman takes it on the chin.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 6/24/92	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	281.964	+ 2.143	+28.250
Loans to Depository Inst.	.224	+ .072	- .141
Float	.468	+ .085	+ .355
Total Reserve Bank Credit	312.594	+ 2.646	+21.384
Treasury Deposits with Federal Reserve Banks	8.136	+ 1.479	+ 2.391
Currency in Circulation	310.125	- .327	+19.570
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	279.902	+ 1.137	+35.987
	6/24/92		
Member Bank Reserves:			
Total Reserves Held	49.510	+ .773	- .881
Excess (Deficiency)	1.162	+ .684	- .120
Net Free Reserves	.974	+ .648	- .002
Monetary Aggregates †		**‡ % Change Since 3 Months Ago***	**Year Ago**
M1 (6/15/92)	953.1	+ 7.1	+ 11.7
M2 (6/15/92)	3,464.9	- 1.6	+ 1.6
M3 (6/15/92)	4,169.8	- 2.7	–0–
Domestic Nonfinancial Debt (4th Q'91)	11,229.1	+ 5.3	+ 4.4

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 6/26/92	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	3.63%	3.70%	3.93%
* Federal Agencies	3.80	3.82	4.10
* Municipal Notes–High Grade (34% Taxable Equivalent)	3.94	4.24	4.55
Negotiable Time CDs Chemical	Rates By Arrangement		
* Secondary Market–Prime	3.60	3.75	4.05

‡ Finance Company Paper–Prime

5- 14 days	3.78%
15- 29 days	3.78
30- 59 days	3.78
60- 89 days	3.78
90-179 days	3.79
180-239 days	3.86
240-270 days	3.88

‡* Bankers' Acceptances

Jul.	3.73%
Aug.	3.73
Sep.	3.75
Oct.	3.75
Nov.	3.78
Dec.	3.78

‡ Industrial Paper–Prime

30- 89 days	3.87%
90-120 days	3.87

†Federal Funds Effective Rate 3.69%

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

	Latest Period or End of Period		Previous Period	Year Ago Period
Gross Domestic Product (Current Dollars)*	1st Q'92	$ 5,821r	$ 5,740	$ 5,589
Gross Domestic Product (1987 Dollars)*	1st Q'92	$ 4,901r	$ 4,868	$ 4,824
Percent Change, Annual Rate	1st Q'92	2.7r	0.4	- 2.5
Change in Consumer Prices*	May '92	1.2%	2.4%	2.4%
Change in CHEM Cost of Living Index*	May '92	1.2%	1.2%	2.4%
Change in Producer Prices*	May '92	4.8%	2.4%	2.4%
Civilian Employment (Thousands of Persons) †	May '92	117,656	117,675	116,730
Unemployment as % of Civilian Labor Force †	May '92	7.5%	7.2%	6.8%
Personal Income*	May '92n	$ 5,008	$ 4,994	$ 4,826
Leading Indicators Composite Index (1967=100) †	Apr '92	148.9	148.3	141.9
Industrial Production Index (1977=100) †	May '92n	108.8	108.1r	106.4
Net Change in Consumer Installment Credit †	Apr '92	- $ 3.82	- $ 0.99	- $ 0.05r
U.S. Merchandise Trade Balance †	Apr '92n	- $ 6.97	- $ 5.58r	- $ 4.51
Plant and Equipment Expenditures*	3rd Q'92	$ 557.5(a)	$ 558.5(a)	$ 527.9
Private Housing Starts (Thousands of Units)*	May '92n	1,230	1,108r	993
New Construction Expenditures*	Apr '92	$ 418.8	$ 420.0	$ 407.0
Total Business Inventories †	Apr '92	$ 816.1	$ 815.7	$ 817.9
Total Business Sales †	Apr '92	$ 548.0	$ 548.9	$ 532.8

*Seasonally adjusted annual rate. † Seasonally adjusted. n-Newly reported figure. r-Revised. a-Anticipated.

THESE AREN'T THE LAST TIMES WE'LL BE FIRST.
FIRST IN PRIMARY RELATIONSHIPS WITH U.S. CORPORATIONS
FIRST IN LOAN SYNDICATION WORLDWIDE
FIRST IN INTERBANK FOREIGN EXCHANGE
FIRST IN ENERGY BANKING
FIRST IN REORGANIZATION FINANCE
FIRST IN TREASURY MANAGEMENT SYSTEMS

Being first is a beginning for us, not an end.

It lets us hit the ground running, a major financial force born of our merger with Manufacturers Hanover Corporation and backed by $119 billion in assets and $8.8 billion in shareholders' equity.

Yet we bring more than momentum and unassailable financial strength to our corporate relationships.

We offer the experience, intelligence and ingenuity our people use to solve financial problems. With this energizing spark, financial strength can realize its full potential, and momentum becomes unstoppable.

Companies in the U.S. and around the world look to us for authoritative advice and fresh, cost-efficient financial solutions as well as financial strength. In 24-hour, integrated markets borrowers and investors alike turn to us for streams of ideas as well as lines of capital.

And in everything we do, and with every company we serve, we seek to build long-term relationships of trust.

First, last and always.

CHEMICAL
The Global Bank

CHEMICAL

Chemical Bank
Bank Window, Church St. Station
New York, N.Y. 10015

First Class
U.S. Postage
PAID
Chemical
Bank

CONGRESSIONAL INFO SERVICE
ATTN: SDI
4520 EAST-WEST HWY
BETESDA,
MD 20814

Financial Digest